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American Institute of Certified Public Accountants. Auditing Standards Division

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# In Our Opinion...

*The Newsletter of the AICPA Auditing Standards Division\**

Volume 9 Number 3

December 1993

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## AUDIT RISK ALERT—1993

In November, the Auditing Standards Division issued the *Audit Risk Alert—1993* to provide auditors an overview of recent economic, regulatory, and professional developments that may affect the audits they perform. Successful audits are a result of a number of factors, including acceptance of clients with integrity; adequate partner involvement in planning, supervising, and performing audits; an appropriate level of professional skepticism; and the allocation of sufficient audit resources to high-risk areas. The Alert addresses risk factors to be considered in audits and can be used as a planning tool for considering matters that may be especially significant.

The nonauthoritative document addresses how auditors should be alert to certain implications of the current economic climate that may mean added audit risks. For example, entities may currently be struggling with their continued existence or, in an attempt to strengthen their financial position, may be reorganizing or restructuring their business operations. This restructuring by some employers may include major layoffs of employees, which result in complex accounting events involving termination benefits and curtailment of pension plans. The decline in interest rates will affect those benefit obligations that are measured on a discounted basis. Impairment of assets, particularly goodwill, may be an accounting issue for entities that are experiencing economic difficulties. In addition, entities that have owned or leased real estate may be affected by the weak real estate market.

In addition, the Alert discusses recent regulatory developments, new auditing pronouncements, and audit communication and reporting issues.

Of importance also, in this year's alert are discussions of the

following "Audit Problems to Watch For" and "Recurring Peer and Quality Review Comments":

- Auditor Skepticism
- Management Fraud
- Significant Transactions or Events
- Dispute Resolution with Audit Staff
- Legal Letters
- Confirmation from Third Parties
- Compliance with Loan Covenants
- Considering or Accepting Employment with a Client
- Audit Risk and Materiality
- Written Audit Programs
- Consideration of the Internal Control Structure
- Analytical Procedures
- Representation Letters
- Communication of Internal Control Structure Related Matters
- Communication with Audit Committees
- Working Paper Requirements
- Review of Working Papers
- Incomplete Financial Statement Disclosures

The Alert provides guidance on working paper retention and client acceptance and retention policies. Overviews of accounting issues and developments are provided on the following: losses resulting from catastrophic events, postemployment benefits, postretirement benefits other than pensions, income taxes, impairment of loans, investments in securities, and contributions received and made.

To order copies of the Alert, call the AICPA Order Department at 1-800-TO-AICPA, Product # 022099, \$10/copy.

## COMPILATION AND REVIEW ALERT — 1993

In December, the Auditing Standards Division issued the *Compilation and Review Alert — 1993*, a nonauthoritative practice aid designed to help accountants perform their compilation and review engagements. The Alert clarifies certain existing professional standards, suggests ways of implementing Statements on Standards for Accounting and Review Services (SSARS) in unusual circumstances, points out pitfalls that frequently occur in compilation and review engagements and summarizes new professional and accounting pronouncements that may affect compilation and review engagements.

Some of the topics covered in the Alert are the following:

**Implementing SSARS No. 7** — SSARS No. 7 is effective for periods ending after December 15, 1993 and contains provisions that change compilation and review practice. The Alert summarizes the provisions of SSARS No. 7 and presents samples of compilation and review reports incorporating the new wording established by SSARS No. 7.

**Financial Statements Submitted Electronically** — Regulatory bodies or other users of financial statements may request that financial statements be submitted on a computer disk or through a data transmission network. The document contains guidance on the applicability of SSARS to financial statements submitted in electronic format and about the mechanics of issuing a report when such media are used.

**Maintaining Independence When Providing Payroll Services** — CPAs may be asked to perform payroll preparation services for compilation or review clients when the employee responsible for payroll is away or when management elects to have this service performed outside the organization. The Alert presents

factors a CPA should consider when providing payroll services to a client in an engagement that requires independence.

**RMA Prescribed-Form Financial Statements** — Robert Morris Associates (RMA), the association of bank lending officers, in conjunction with the Technical Issues Committee of the AICPA, has developed the *Business Credit Information Package* (BCIP) to be used by small businesses when applying for credit from financial institutions. The Alert provides an update on the BCIP which features a prescribed form for financial statements that requires selected disclosures rather than full disclosure and is tailored to the information needs of financial institutions. RMA introduced the BCIP at its annual conference in September 1993, therefore CPAs can expect to see these forms in their practice shortly.

**GAAP for Compiled or Reviewed Financial Statements** — Although there are different reporting and performance standards for compilation, review and audit engagements, the accounting principles to be followed in compiled and reviewed financial statements are the same as those in audited financial statements. The definition of GAAP and the hierarchy of established accounting principles presented in SAS No. 69, *The Meaning of "Present Fairly in Conformity With Generally Accepted Accounting Principles" in the Independent Auditor's Report*, are applicable to compilations and reviews of financial statements. The Alert identifies and describes the publications that contain pronouncements included in levels *a* through *d* of the GAAP hierarchy (must know GAAP).

To order copies of the *Compilation and Review Alert — 1993* call the AICPA Order Department at 1-800-TO-AICPA, and request Product # 060666, \$10/copy.

## TECHNICAL PLAN HIGHLIGHTS

**Accounting and Review Services** (Staff Aide: JUDITH SHERINSKY). The Accounting and Review Services Committee will meet in the first quarter of 1994 to discuss issues related to an accountant's association with Medicare Cost Reports. Some of the issues that will be discussed are the applicability of SSARS to Medicare Cost Reports, the mechanics of submitting a report in electronic format (on a computer disk or through a data transmission network), and the accountant's responsibility for supplementary schedules.

**Agreed-Upon Procedures** (A. LOUISE WILLIAMSON). The Agreed-Upon Procedures Task Force is considering amendment or expansion of the performance and reporting guidance in professional standards dealing with agreed-upon procedures engagements. The task force is considering guidance concerning the practitioner's reporting responsibility for both findings and assurances in such engagements. The task force is also considering whether internal auditors may be used in agreed-upon procedures engagements and what effect the use of internal auditors would have on agreed-upon procedures reports. In addition, the task force has updated the related issues paper that was presented to the Auditing Standards

Board (ASB) in June 1990 identifying all instances in the professional standards where negative assurance based on agreed-upon procedures is permitted. The task force presented a proposed statement for agreed-upon procedures engagements at the December 1993 ASB meeting and is expected to continue its discussion at the February 1994 ASB meeting.

**Analytical Procedures** (ERIC NICELY). The Analytical Procedures Task Force will consider certain issues related to Statement on Auditing Standards (SAS) No. 56, *Analytical Procedures*, to determine whether the standard needs to be revised. The task force would consider whether to expand SAS No. 56 to provide additional guidance for a practitioner to perform analytical procedures as part of their substantive tests, including when use of analytical procedures is appropriate, cautions regarding use, and effectiveness of different analytical techniques. The task force would evaluate how analytical procedures may assist in the detection of fraud and how closely analytical procedures should be tied to the audit risk model, including whether expectations should be developed. The task force would also make recommendations for topics to be included in an Auditing Procedures Study

(APS) on analytical procedures. (APSs provide practitioners with non-authoritative practical assistance concerning auditing procedures.)

**Audits of Small Businesses** (ALAN WINTERS). The APS titled *Audits of Small Businesses* is being revised to reflect SAS Nos. 53-62. The chapters on evaluating internal controls and on performing analytical procedures will be revised to discuss the implementation of SAS Nos. 55 and 56, *Consideration of the Internal Control Structure in a Financial Statement Audit* and *Analytical Procedures*, respectively, in small business audits. Other changes will be made throughout the study to provide guidance that is consistent with recently-issued standards. The revised APS will be available in the second quarter of 1994.

**Audit Sampling** (ALAN WINTERS). A task force is developing an APS to replace the Audit and Accounting Guide, *Audit Sampling*. The APS updates the guide for recently issued SASs. A final APS is expected to be issued in the second quarter of 1994.

**Auditing "Soft" Accounting Information** (JUDITH SHERINSKY). The task force is examining existing and proposed accounting standards that generate "soft" financial statement information to determine what additional guidance auditors may need to audit this information. An example of "soft" accounting information is the estimates contained in financial statements. In October 1993 the task force drafted a comment letter for the ASB on the Accounting Standards Executive Committee's proposed SOP, *Disclosure of Certain Significant Risks and Uncertainties and Financial Flexibility*. The task force will be addressing the Public Oversight Board's recommendation that the ASB revise the auditor's standard report to make the prospective nature of certain accounting estimates clear and to indicate that the estimated results may not be achieved.

**Compliance Attestation** (JEANNIE SUMMO). The ASB has approved for final issuance a Statement on Standards for Attestation Engagements (SSAE) titled "Compliance Attestation." The Statement (SSAE No. 3) will provide guidance to practitioners engaged to perform services related to an entity's compliance with specified laws or regulations. (Publication is expected in December 1993.)

**Computer Auditing** (JANE MANCINO). The Computer Auditing Subcommittee is forming a task force to consider audit issues pertaining to electronic evidence. The Subcommittee is also currently drafting four APSs. The first addresses the possible effects of advanced EDP systems on the auditor's consideration of an entity's internal control structure over financial reporting. The second updates the guidance in the Audit and Accounting Guide, *Computer-Assisted Audit Techniques*. The third study describes client server computing and its possible effect on the financial statement audit. The fourth study is a joint project with the Canadian Institute of Chartered Accountants on the possible audit impact of Electronic Data

Interchange and Digital Image Processing. The first and second studies are expected to be published in the first half of 1994, the third study in 1994, and the fourth in 1995.

**Forecasts and Projections** (DAN GUY/LINDA VOLKERT). The Forecasts and Projections Task Force monitors and addresses problems encountered in implementing the guidance in the *Statement on Standards for Accountants' Services on Prospective Financial Information, Financial Forecasts and Projections*. An updated AICPA Audit and Accounting Guide, *Guide for Prospective Financial Information*, was published in March 1993.

**Fraud** (JANE MANCINO). The Fraud Task Force will begin in 1994 to consider clarifying the auditor's responsibility for the detection of fraud as described in SAS No. 53, *The Auditor's Responsibility to Detect and Report Errors and Irregularities*. In addition, the task force will consider revising factors that may indicate increased risk of management fraud and providing separate indicators of employee fraud such as defalcations. Based on the above, the task force will evaluate whether a need exists to revise the auditor's report.

**Internal Control Guidance** (ALAN WINTERS). A task force was formed to propose necessary revisions to SAS No. 55, *Consideration of the Internal Control Structure in a Financial Statement Audit*, to reconcile with the Committee of Sponsoring Organizations (COSO) of the Treadway Commission's Report titled *Internal Control — Integrated Framework*. The task force is also considering whether revision to other related professional standards is necessary. The task force will present its recommendations at the February 1994 ASB meeting.

**Not-for-Profit Organizations** (A. LOUISE WILLIAMSON). The Not-for-Profit Organizations Committee issued SOP 92-9 titled *Audits of Not-for-Profit Organizations Receiving Federal Awards*, in December 1992. The SOP provides implementation guidance for audits conducted in accordance with Office of Management and Budget Circular A-133. The SOP amends certain related AICPA Audit and Accounting Guides.

**Reporting on Internal Control** (A. LOUISE WILLIAMSON). In May 1993, the ASB issued SSAE No. 2, *Reporting on an Entity's Internal Control Structure Over Financial Reporting* (Product # 023056), which supersedes SAS No. 30, *Reporting on Internal Accounting Control*. SSAE No. 2 is effective for examinations of management's assertion when the assertion is as of December 15, 1993 or thereafter. This statement provides guidance to the practitioner engaged to examine and report on management's written assertion about the effectiveness of an entity's internal control structure over financial reporting. Among other provisions, it establishes standards for accepting, performing and reporting on examination engagements for such assertions. The ASB has requested that the task force review SAS No. 58, *Reports on Audited Financial Statements*, the Interpretation to SAS No. 8, *Other Information in Documents Containing Audited Financial Statements*, and

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the Interpretation to SAS No. 30 to determine whether this guidance needs to be amended as a result of the new SSAE. At its October 1993 meeting, the ASB reached a consensus to delete the Interpretation to SAS No. 30. The task force discussed related recommendations at the December 1993 ASB meeting and is expected to continue its discussion at the February 1994 ASB meeting.

**SAS No. 11 Guidance** (JEANNIE SUMMO). The SAS No. 11 Guidance Task Force was formed to consider whether the guidance in SAS No. 11, *Using the Work of a Specialist*, continues to be appropriate. The task force developed a proposed revision to SAS No. 11 which incorporates into the proposed standard the conclusions in the two interpretations to SAS No. 11 and also refines the guidance on using a specialist who is related to the client. The document was issued as an exposure draft SAS in April 1993 with a comment period ending June 30, 1993. The Board will discuss a revised draft of the document at an ASB meeting in early 1994.

**SAS No. 59 Guidance** (JUDITH SHERINSKY). The task force is considering issues related to SAS No. 59, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*, to determine whether there is a need for additional guidance in the form of amendment or interpretation of SAS No. 59. The task force is monitoring the United Kingdom's proposed standard on going-concern which requires auditors to perform procedures specifically designed to audit the going-concern assumption.

**SAS No. 68 Revision** (A. LOUISE WILLIAMSON). A task force was formed to consider revisions to SAS No. 68, *Compliance Auditing Applicable to Governmental Entities and Other Recipients of Federal Financial Assistance*, as a result of newly issued

guidance in SOP 92-7, *Audits of State and Local Governmental Entities Receiving Federal Financial Assistance*, SOP 92-9, *Audits of Not-for-Profit Organizations Receiving Federal Awards*, and the draft proposed Audit and Accounting Guide, *Audits of State and Local Governmental Units*. The task force will consider the effect of proposed revisions to the General Accounting Office's (GAO's) *Government Auditing Standards* and possible revisions to the Single Audit Act of 1984 resulting from studies conducted by the GAO and the President's Council on Integrity and Efficiency. The task force presented a draft of revisions to SAS No. 68 at the December 1993 ASB meeting and is expected to issue an exposure draft SAS in the first quarter of 1994.

**SAS No. 70 Auditing Procedure Study** (JUDITH SHERINSKY). The task force is developing an Auditing Procedure Study (APS) that will provide guidance to auditors on implementing SAS No. 70, *Reports on the Processing of Transactions by Service Organizations*. The APS will provide guidance to service auditors on performing and reporting on a service auditor's engagement and to user auditors on using a service auditor's report in the audit of the financial statements of a user organization. An example of a service organization is a bank trust department that invests and holds assets for employee benefit plans. The task force expects to issue the APS in the first quarter of 1994.

**9000 Review** (JEANNIE SUMMO). The task force recently completed its review of exposure drafts of International Standards on Auditing and drafted the AICPA's comment letters on such drafts. The task force receives various assignments on a continuous basis from Division staff and the ASB's Audit Issues Task Force.